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Classified By: Ambassador J. Thomas Schieffer, for reasons 1.4(B) and (
D).

¶1. (C) Summary. Japan's pro-reform forces in the past had used the Regulatory Reform and Competition Policy Initiative with the U.S. to push recalcitrant parts of the Japanese bureaucracy to make needed changes. However, the latest (seventh) round of regulatory reform talks show the waning interest in reform seen in top political levels has seeped down to working level GOJ officials. Without high-level political interest and support for economic reform like that provided by then PM Koizumi at the launch of the Initiative in 2001, the urgency for reform in Japan's bureaucracy has declined and the working- level officials who carry out the regulatory reform process have taken a conservative, do-as-little-as-possible approach. Japan needs to re-ignite regulatory reform to help Japan's economy grow and be better positioned to face emerging global challenges. End summary.

¶2. (C) The U.S.-Japan Regulatory Reform and Competition Policy Initiative covers an extensive array of issues important to U.S. business in five separate working groups, headed by USTR on the U.S. side and the Foreign Ministry on the Japanese side. The dialog started at a time when Japan's economy was in obvious, deep trouble. Then Prime Minister Koizumi recognized that after ten plus years of unsuccessful attempts to jump start the economy through fiscal stimulus packages alone, that deeper, more serious structural reforms were needed. Reform-minded bureaucrats on the Japanese side used the dialog to push recalcitrant parts of the GOJ to introduce more market-oriented, trade-promoting policies. The GOJ side also zeroed in on impediments they saw affecting Japanese companies doing business in the U.S., such as visa regimes.

¶3. (C) The Regulatory Reform Initiative remains vital to the U.S. business community as a forum where a broad array of concerns are raised and worked through between the U.S. and Japan. Compared with past successes since the process was launched in 2001, this year's round revealed the extent to which momentum for economic reform within the GOJ has waned. In areas where there had been flexibility, positions seem to have hardened. Prime Minister Fukuda is no Koizumi, with neither the passion for economic reform nor the political charisma or clout to carry it off were he so inclined. As a result, the bureaucrats who work the nuts-and-bolts issues that are key to general reform have little or no interest in taking risks or making the extra effort to move the process forward. Furthermore, the bureaucrats have little to no pressure to advance reform from the ruling Liberal Democratic Party or the Prime Minister's office, which contributes to their unproductive attitude. Increasingly, we see obfuscation or indifference on the issues of concern to U.S. business. Even where senior GOJ officials are committed to

reforms, the working-level resisted language showing progress on these issues in the Report to Leaders being drafted to document the achievements of the latest round of the Initiative.

¶4. (C) One example of GOJ foot dragging involves Japan Post. Privatization of Japan Post, with $3 trillion in assets, for several years has been the biggest ticket item on the Regulatory Reform agenda and the centerpiece of Koizumi's reform efforts. The implications of this measure extend in several directions, including insurance and banking as well as traditional postal and delivery services. Focus has shifted from how privatization should be pursued to how to ensure fairness and transparency in implementation, including urging Japan to treat Japan Post's international express delivery service on an equivalent basis with private sector competitors. Yet during working group drafting sessions in Tokyo the week of June 10, GOJ negotiators balked on virtually all the language the U.S. suggested, including such points as extolling the need for transparency and fairness. Very little of the text was agreed on and the two sides will resume discussions by video conference.

¶5. (C) There were problems as well with the Ministry of Health, Labor, and Welfare (MHLW) blocking progress on the key agricultural trade issue -- the GOJ's onerous 100 percent "test and hold" import restrictions applied on a country-wide basis in the event of two violations of Japan's maximum residue level (MRLs) for pesticides, which can have a devastating impact on U.S. fruit and vegetable exporters. At May's high level regulatory reform meetings in Washington, Deputy Foreign Minister Masaharu Kohno, leading the Japanese

side, promised to find a solution based on a USG proposal for American industry to "self certify" in cases where Japan has a lower MRL tolerance level than in the U.S. However, during June's working-level meetings in Tokyo, MHLW officials balked, leaving the issue unresolved. The U.S. has put the issue on the WTO SPS Committee agenda for late June to leverage chances for progress.

¶6. (C) There were problems, too, with talks on financial services, a surprising development given the positive steps FSA has taken in developing its &Plan for Enhancing the Competitiveness of Japan's Financial and Capital Markets8 and the actual progress on issues of critical interest to U.S. firms, such as firewalls. A combination of intransigence and tardiness by the Financial Services Agency (FSA) prevented the two sides from working out a text before the deadline, and appeals for additional meetings went unanswered. On-going USG requests for clarification of the GOJ's policy toward global custody of financial assets prompted multi-page questionnaires from the FSA, suggesting that not only had no action been taken, but that the regulators did not fully grasp the nature of the U.S. recommendations.

¶7. (C) Japanese bureaucratic stove-piping was on full display in the defined-contribution pension element of the financial services negotiations. Although this MHLW-overseen program's viability hinges on favorable tax treatment from the Ministry of Finance (MOF), MOF officials failed to attend the session of the June regulatory reform talks on this subject despite numerous requests that they do so. This situation occurred despite frequent statements by politicians and public polls showing pensions are a high-anxiety issue for the average Japanese. On the eve of the talks, a MOFA official told us he was "shocked" MOF had not dispatched representatives and suggested the U.S. side should appeal directly to MOF, implying MOFA's lack of leverage with other elements of the GOJ bureaucracy.

¶8. (C) Some negotiations over the Report to Leaders went better than others. Negotiators in the Cross-sectoral Working Group could draw on recent positive GOJ developments

to include in the Report so that it shows the potential progress that could be made on commercial law issues in the coming months. A timely policy initiative, endorsed by Japan's Council on Economic and Fiscal Policy (CEFP) in mid-June that set Japan's ministries to work on improving Japan's investment climate, helped. The U.S. team also drew on the FSA's December 2007 Plan for Strengthening the Competitiveness of Japan's Financial and Capital Markets, the revised Tokyo Stock Exchange (TSE) Code of Corporate Conduct, and its three-year medium term management plan for forward-leaning language on the importance of transparency and timely disclosure of corporate reports and to highlight the TSE's renewed commitment to find ways to improve corporate governance. There was less success in securing Justice Ministry commitment to allow foreign law firms in Japan to open branch offices or for certain foreign corporations to reincorporate as Japanese firms.

¶9. (C) Progress in the medical devices and pharmaceuticals (MedPharm) talks was mixed. The U.S. continues to urge Japan to promote policies that reward innovation in a sector worth $5 billion to U.S. industry -- in respect to pricing but also to improving regulatory practices to end onerous lags in the availability of some pharmaceuticals and medical devices in Japan. The GOJ side resisted any language in the Report to Leaders that would have reduced GOJ freedom of action, but MHLW did agree to provide industry with opportunities to make proposals on pricing reform in Japan, including specific proposals to improve the economic return for patented drugs. The Health Ministry also took steps to stimulate clinical trials and enhance clinical trial consultations -- set to increase in 2008 to 420 from 280 last year. The Ministry set up as well a specific government/industry task force to discuss regulatory review and approval of new medical devices.

¶10. (C) Talks on telecommunications and IPR issues, covered in separate working groups, also saw mixed results. Japan continued efforts to promote competition in the telecommunications sector, but would not move on the priority U.S. principle of technology neutrality. The IPR discussions on patent cooperation have brought real gains, but the GOJ remains unwilling to use tools like statutory damages or ex officio investigative authority to strengthen its enforcement

regime.

¶11. (C) Comment -- The examples cited above are parts of a much larger and more complex set of negotiations. The value in continuing to urge Japan to make reforms through this initiative remains as important as ever. However, the examples also reinforce the impression Japan's political leadership is doing very little to inspire the working-level officials who conduct the Regulatory Reform Initiative to act positively. Those concrete reform steps by Japan reflected in the draft Report to Leaders this year are, by and large, follow-on work from policy decisions made two years ago or before. We need to urge the Japanese to reignite their enthusiasm for economic reform, lest Japan get left behind in a rapidly changing global economy. End comment.
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